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Thesis

STATE DEBT REPUDIATIONS

IN THE

UNITED STATES

by

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Introduction

The purpose of this thesis is to present a concise statement of a subject which is of recurring interest and importance. As long as debt repudiation by governments has been practiced, it has been of continual interest in the field of public finance. Because debt repudiation has become part of the history of the States in this country, the topic seems to be always available for international discussions, even after the passage of a hundred years.

Controversy marks every possible approach to this subject. Most of the material on the subject came into being as a result of disappointment by investors or resentment by States' apologists of the criticism which has been heaped on the inhabitants of the offending States in particular and the United States in general.

Repudiation seems to involve:

- (a) the methods of financing adopted by the States,
- (b) the policies, formulated by the judicial or the elected legislative or administrative branches of the State governments, which have been applied in attempts to replace the States in solvent positions, and,
- (c) law, traditional standards by which duties and con*

tractual obligations are measured.

According to the relative place of prominence given to these three items, the existence or degree of repudiation can be determined. For instance, if we do not distinguish between good and bad ways of State financing, if we believe a court or a legislature or an official has the right to eliminate the necessity of repaying a loan made to the State, or if we hold that legal principles differ with the status of the parties, then an act, whereby a debt which was once considered valid is renounced, does not constitute repudiation.

Hence, there is disagreement over what States "repudiated" debts and what States merely "adjusted" or "recognized" debts.

It is quite obvious, then, that any act of "repudiation" has many aspects, namely, ethical or moral, legal, economic, and social. And these are all intertwined. But this thesis concerns mainly the economic aspects, since fields of knowledge other than Economics must be employed for the accurate treatment of the other aspects of the subject. As may be noticed, however, an attempt has been made to consider the subject sufficiently as a whole to recognize the effects of the moral, legal, and social aspects with regard to the purely economic considerations.

Extreme diversification has characterized the sources of information about this subject. They range from two poems by William Wordsworth to the United States Supreme Court Reports. Aside from the books on the subject, there have been news articles, editorials, and letters to the editors of "The Christian Science Monitor", "The New York Times", "The Chicago Tribune", "The New York Herald Tribune" and various foreign papers, during the mid 1920's and early 1930's. There have been debates in the House of Lords and suggestions on both sides of the Atlantic that the repudiated debts be considered as some payment against the European debts to the United States. Pamphlets and journal articles have revived the subject whenever it hasn't been publicly active from a political standpoint.

In so far as possible, these sources have been checked and have been supplemented by correspondence with several of the State Treasurers, other officials of the States involved, and representatives of the Council of Foreign Bondholders.

Chapter I.

Repudiation In Meaning And In Practice

Definition of Repudiation:

In this study on "Foreign Bonds", Dr. Max Winkler gives the definition of repudiation which has been taken as the guide in this study. It is this:

"Governmental default, irrespective of classifications and erudite definitions, is briefly the repudiation by a government of a contractual debt owed by it either to domestics or foreigners, thereby rendering itself guilty of a breach of its obligations under domestic or international, and always moral, law."¹

Historically, the word "Repudiation" goes back to the Romans. It is made up of "re", which indicates rejection, and "pudere", "to be ashamed of". As Dr. Winkler phrases it, in present financial language, the inference is that the "repudiator is to be ashamed only of himself".²

Another definition, particularly applicable to the term as used in this study, has been given in "The New International Encyclopedia";

"Repudiation- refusal of a state or government to pay its debt; grows out of the practical bankruptcy of the state, though it often seeks justification in the plea that the obligations previously admitted were illegal and therefore invalid. Debt scaling by refunding operations frequently approaches repudiation in its prac-

¹ Winkler, M., Foreign Bonds (Philadelphia, 1933), p. 9.

² Ibid., p. 8.

tical effects, though it generally escapes the reproach of the name unless there are obligations or classes of obligations which are wholly ignored in the process."³

Several other authorities have been found in substantial agreement with these definitions.⁴

Although the practice of repudiating a public debt is known to be ancient⁵ and also quite widespread,⁶ there was a distinct influence on the use of the term, "Repudiation", brought about by the actions of the American States. Evidence of this appears in "A New English Dictionary on Historical Principles". Part of the lengthy definition given for "repudiate" is as follows:

"1847-Webster, s.v., The State has repudiated its debts....1862-J. Spence Amer. 74. In each of the States that has repudiated there was a large majority of men thoroughly honourable in their private affairs....Repudiation has not been the course of those who could not, but of those who, having the means, would not pay. Hence, repudiationst, U.S., one who advocates the repudiation of a public debt."⁷

3 The New International Encyclopedia, Vol. XIX, 1930, p. 717.

4. See Black's Law Dictionary, p. 1536-7; The Encyclopedia Americana, Vol. XXIII, p. 406; Encyclopedia of Banking and Finance, p. 695; Webster's Practical Dictionary (1942); Winston's Encyclopedia, Vol. VIII.

5 Winkler, op. cit., p. xiv. Reference to Dionysius of Syracuse who debased the country's currency in order to reduce its outstanding indebtedness.

6. Winkler, op. cit., p. 182-205. Aside from the states of the United States which are mentioned, the following places are listed among "Government, State and City Bonds in Default": Argentina, Austria, Bolivia, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Ecuador, Germany, Greece, Guatemala, Hungary, Jugoslavia, Latvia, Mexico, Panama, Peru,

"The New International Encyclopedia" also attaches a note to its definition which reads,

"Among nations and states of weak public credit the practices mentioned are only too familiar, but the odium of the name attaches particularly to the history of the financing of the American commonwealths." ⁸

Methods of Repudiation:

Repudiation has been accomplished in at least four ways. The most popular method, known as "scaling-down" the debt, was a procedure by which the State Legislature would pass a law providing for the exchange of outstanding bonds with new bonds at a ratio in the state's favor, i.e. \$1,000, 6% bond replaced officially by a \$500, 4% bond. ⁹

Another method was for the State Courts to determine a particular issue of bonds fraudulent. Then the state would interpret the decision as meaning that there was no obligation to pay. Seldom was there any assessing of specific responsibility for the fraud.

Rumania, Russia, Salvador, Turkey, and Uruguay.

7 Murray, J.A.H., ed., A New English Dictionary on Historical Principles, Oxford, (1914), Vol. VIII, p. 492, 3. Craigie, W.A., contributor.

8 The New International Encyclopedia, op. cit., p. 717.

9 Campbell, A.J., "Defaulting States of America", Nineteenth Century, January, 1932, p. 84-90. Debts were scaled down in varying amounts, 24 to 50 %. (In some cases, the bondholders agreed, but this doesn't change the nature of the action.)

At times the State Legislature merely passed an act declaring one or more specified bond issues fraudulent and therefore invalid. At least on the record this official act was supposed to eliminate the state's future obligations as to those issues even though the state most likely had recognized those same issues with partial payment of principal or interest.

The fourth method, used in Mississippi, was the passage of an amendment to the State Constitution which made it illegal for the elected officers of the state to repay or receive in payment to the state any bonds of specified issues.

Repudiation and the Law:

In the Spring of 1841 the Rothschilds, Hope & Co., and Joshua Bates of Baring Brothers & Company addressed letters to President Tyler and Daniel Webster, Secretary of State, calling their attention to the non-payment of obligations by Indiana, Florida and Mississippi. The President issued a statement to the effect that the states alone were responsible for their indebtedness. It was his belief that the states would pay.¹⁰

¹⁰ McGrane, R.C., Foreign Bondholders, New York, (1935), p.31.

Thus, at a very early date, investors, through these prominent brokers, were given accurate advice, the President's belief notwithstanding.

The provision of Article I, Section 10, of the Constitution of the United States has been of little use to creditors, mainly because of another part of the same Constitution, namely, Amendment XI. These sections read:

Article I, Section 10:

"The creditor of a State has a contract right which the legislature cannot impair by subsequent enactment."

"No State shall pass any bill of attainder, ex post facto law, or law impairing the obligation of contract."

Amendment XI:

"The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another State, or by citizens or subjects of any foreign State."

In Senate Documents, Volume 118, Amendment XI has been interpreted in the light of the decisions of the leading cases concerning the suits on State Contracts. It is stated there that,

"Those who deal in bonds (on State Contracts) and obligations of a Sovereign State are aware that they must rely altogether on the sense of justice and good faith of the State, and the courts of the United States are expressly prohibited from exercising jurisdiction." 11

11 Campbell, A.J., op.cit., p.86.

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In Encyclopedia of Banking and Finance, Glenn Munn offers a good summary of the law and repudiation with these sentences,

".....Repudiation may be complete or partial. The term is usually applied to the refusal of a government or civil subdivision thereof to pay a bonded obligation. Whenever a sovereign power, e.g., a national government or state, repudiates its debts, the citizens who have bought its bonds have no recourse, since an individual has no power to sue a sovereign power without its consent. A municipality, however, may be sued. Although a national government may repudiate its obligations, very few instances of such repudiation are on record."¹²

In Jordan V. Madsen, (Utah 252 at 570,573), the Court held that,

"Where one party to contract refuses to perform except on material modification or addition of new terms, such conduct amounts to 'repudiation!'"

Republic of Cuba v. State of North Carolina:

The Supreme Court of the United States has been petitioned to review and rule upon the validity of repudiated State bonds, but has never rendered a decision.

The Special Tax Bonds of North Carolina, issued in aid of railroads by the socalled "carpetbag" General Assembly of 1868-1869, have featured in attempts to gain a Supreme Court ruling, even as recently as a few months

¹² Munn, G.G., Encyclopedia of Banking and Finance, New York, (1937), p.695.

ago.

A summary of the circumstances surrounding the two Supreme Court dispositions of the North Carolina cases is given by former Assistant Attorney General of North Carolina, Frank Nash,

"The State of North Carolina at no time derived any substantial benefit from the sale of these bonds. Nearly all their proceeds were diverted to base uses. Some work was done upon one or two of the railroads, but it was of such character as not to contribute to the completion of these railroads. So entirely convinced were the people of the State of the injustices of any attempt to make the State liable for these bonds, that in 1880 they adopted a constitutional amendment which forbids the legislature to make any provisions for their payment, unless thereto authorized by a majority of the qualified voters of the State (Sec.6 of Art.1 of present Constitution).

"Several attempts have been made by those interested to get a standing in court to enforce the payment of these bonds, but the Eleventh Amendment to the United States Constitution blocked the way into the Federal Courts (North Carolina vs. Temple, 134 U. S., 22), and the State Constitution closes the doors of the State courts to them (Baltzer vs. State, 104 N.C., 265). The most notable and most recent of these attempts was through the Republic of Cuba. The owner of the bonds, in number 895 of the par value of \$895,000, exclusive of interest, donated them to the Republic. It applied to the United States Supreme Court, in the exercise of its original jurisdiction for leave to bring an action against North Carolina. Upon the showing of the State in answer to a citation from the Supreme Court the Republic withdrew its application (242 U.S., 663).

"The legal validity of these bonds has never therefore been presented to any court, and from the nature of the thing it is scarcely possible it ever will be." ¹³

¹³ Nash, Frank, The Special Tax Bonds of North Carolina and Their Repudiation, Raleigh, (1926), p.6.

In February, 1949, the League of Ohio Sportsmen gave 200 North Carolina bonds, \$1,000 face value for each, to the Conservation Commission of the State of Ohio.¹⁴ As Governor Frank J. Lausche states in his letter to the writer, "it was expected that the State of Ohio would sue the State of North Carolina on these bonds".¹⁵

Just as in the Republic of Cuba case, the original owners of these bonds planned to obtain a settlement once the Supreme Court of the land rendered a decision. But Governor Lausche elected not to become a party to the legal scheme. He was advised by the Attorney General of North Carolina that previous attempts had been made by bondholders in the States of Oklahoma and Ohio.¹⁶

Principality of Monaco v. State of Mississippi:

On September 27, 1933 at its Paris Legation the Principality of Monaco received as a gift some \$100,000 (face value) of two issues of Mississippi Planters' Bank Bonds and two issues of Mississippi Union Bank Bonds. Those of the Planters' Bank were dated March 1, 1833 and were due March 1, 1861 and March 1, 1866, respectively, with 6% interest. Those of the Union Bank were dated June 6 and 7, 1838 and were due February 5, 1850 and February 5, 1858,

¹⁴ "Lausche Fights Plan to Sue North Carolina", The New York Times, February 27, 1949.

¹⁵ Letter dated March 23, 1949. See Exhibit I.

¹⁶ The New York Times, op. cit.,

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respectively, with 5 % interest.¹⁷ The gift was made by three persons whose families had held the bonds for over ninety years.¹⁸ Lord Tweedsmouth donated \$80,000, Mrs. Hugh Eliot, \$16,000, and Mr. G. Del Drago, \$10,000.¹⁹ The purpose of the gift, as stated, was to provide educational and charity funds for the Principality. However, it was well known that the other holders of these bonds were ready to present them if Monaco prevailed in a suit brought in the Supreme Court of the United States, (292 U.S. 313). It was alleged that a foreign government had the right, within the provisions of the Constitution of the United States, to bring suit against a State in the Supreme Court.

On January 9, 1934, the State of Mississippi was given until February 5 to show cause why the Principality of Monaco should not have permission to file suit to enforce payment of \$574,300.²⁰ Note that the interest was practically five times the principal. The State of Mississippi stood firm on its sovereign power and refused to give permission to be sued, a fact which was conclusive to Chief Justice Hughes' decision to deny the motion on May 21, 1934.

¹⁷ 292 U.S. 313, Prin. of Monaco vs. State of Miss.

¹⁸ Ibid.

¹⁹ "The World's Business", The Christian Science Monitor, January 12, 1934.

²⁰ The Christian Science Monitor (News Section), Jan. 9, 1934.

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There was an amendment to the Mississippi Constitution passed in 1876 and this provided that the State should not "Assume, redeem, secure, or pay any indebtedness or pretended indebtedness" by the State of Mississippi to holders of Union Bank bonds or Planters' Bank bonds. This provision was incorporated in the Constitution of 1890.²¹

Ever since then, the State has taken the view that it is bound by its Constitution not to recognize these "outlawed" bonds.²² Hence it was the State Legislature in 1830 and in 1838 which decided on issuing bonds to the Planters' Bank at first and then later to the Union Bank in return for bank stock and it was another legislature which decided that the State was not obligated to pay back even the principal of these bonds.²³

Mr. James P. Cooper, Secretary of the Council of Foreign Bondholders, contended quite validly that because these investments proved unwise and unsuccessful for the State was no reason why the State should feel justified in repudiating these bonds in 1841, which, as he points out, was twenty years before the Civil War and thus, in no way, connected with this conflict.²⁴

²¹ 292 U.S. 313 at 314.

²² The New York Times, December 18, 1932.

²³ The New York Times, June 20, 1926.

²⁴ "Letter to the Editor", The Christian Science Monitor, May 20, 1925.

Chapter II.

Causes of State Debt Repudiation

In a release entitled "Repudiation of State Indebtedness", the United States Treasury Department offers this list of the causes of repudiation,

- "(1) Earlier repudiation followed the disastrous financial crisis of 1837. Later repudiation occurred in the Reconstruction Period following the Civil War.
- (2) Reckless finance and fraud.
- (3) In some States the cry of illegality was raised, the question got into politics and the bonds were repudiated.
- (4) The Civil War greatly reduced the taxable basis and the financial situation was desperate.
- (5) The Civil War greatly weakened the idea of State sovereignty and feeling of State responsibility. Amendment XIV required repudiation of all debts contracted in the United States in aid of the rebellion and it was not easy for the Southern States to discriminate between these and their other debts."¹

However, it is most doubtful that any instance of repudiation can be traced to any single cause or type of cause. Repudiation is a final desperate act generally following a complicated series of actions often by more than one generation. The purpose here is to offer basic and more realistic reasons why new, expanding states in the presently most prosperous country in the world fell to the depths of financial entanglement.

¹ United States, Treasury Department, (as stated).
This report is based largely on W.A.Scott's book,
herein cited.

1. Fraud and corruption were based on a disinterested majority of the electorate which tolerated continual mismanagement of State government.

All the evidence points to fraud and corruption in the State governments when the repudiated bonds were issued. But this is tied directly to a disinterested majority of the electorate which refused to assume the responsibilities of government. Mismanagement was tolerated in the State governments for lengthy periods of time; or else unjust debts would never have arisen.

McGrane refers to the attitude of the electorate in these words,

"In the South and West, the great mass of people were not interested in the subject of Repudiation. They gave little thought to monied and commereial transactions. ... The moral force of sustaining public faith weighed lightly with those who were overwhelmed by their own personal indebtedness and therefore the legislatures had few who urged maintenance of state credit."²

With understandable vehemence, Lord Bryce wrote in "The American Commonwealth",³

"But perhaps the commonest form of robbery, and that conducted on the largest scale, was for the Legislature to direct the issue of bonds in aid of a railroad or other public work, these bonds being then delivered to contractors, who sold them, shared the proceeds with the governing ring, and omitted to execute the work. Much money was, however, taken in an even more direct fashion from the state treasury or from that of the local au-

² McGrane, R., op.cit., p.39.

³ Vol.II, p.478.- Quoted in The Christian Science Monitor, April 10, 1925.

thority; and as not only the guardians of the public funds, but even, in many cases, the courts of law, were under the control of the thieves, discovery was difficult and redress unattainable."

2. Rapid internal development during the 1810-1840 period gave "talking points" to the legislators (who were also personally interested in banking and the construction of railroads and levees) and to the bond salesmen⁴ (whose commissions were high on state bond issues).

Against the thought that the investors should have been more cautious must be weighed the consideration of the rapid settlement of the trans-Alleghany region. Six States (Louisiana, Indiana, Mississippi, Illinois, Alabama, and Missouri) were admitted in the nine years, 1812-1821. McGrane says that between 1821 and 1831, the population of these States together with that of Kentucky, Tennessee, and Ohio increased from a little over two millions to nearly four millions, the rate of increase of the individual States ranging from 22% in Kentucky to 185% in Illinois.⁵

Railroads to connect the western farmers with the eastern settlements and banks to service all business seemed to be the best possible outlets for investment. Had they been properly managed, they undoubtedly would

⁴ McGrane, R., op.cit., p.18. "As the flood of new states' securities increased in volume, American states began to send agents direct to Europe to negotiate the loans. Every assurance was given by these high-pressure salesmen that the loans were adequately secured."

⁵ Ibid., p.3.

have been just as good as they appeared. But the extent to which the aforementioned legislators and brokers⁶ overdrew the account of the investors in order to finance the internal improvements can be seen from these quotations from the American Almanac of 1840,⁷

"Total Indebtedness of American States

1820	\$12,790,728.
1830	26,470,417.
1835	66,473,186.
By 1839	More than 170,000,000."

"American State Bonds Issued or Authorized
By 1839

\$69,201,515	for	canals
42,871,084	for	railroads
6,618,958	for	turnpikes"

3. Because most of the investors placed their money in these bonds for the reasons that they sold under par⁸ and had higher interest rates than any others (two distinct signs of weakness), the investors were speculating and became parties to the mismanagement of the States.

As mentioned in the descriptions of the instances of repudiation, there were several times when investors were warned by the public press as well as by the more reliable brokers that bond issues of certain States were bad risks. The London Times, which really forecast

⁶ McGrane, R., op.cit., p.8. "American agents frequently disregarded and openly flaunted state statutes. Bonds were sold on credit and below par....American bankers aided and abetted them."

⁷ Ibid., p.6.

most accurately the future happenings, had asked what would occur if a local government (i.e. a State) with all its sense of "a moral as well as a legal obligation" were outvoted. The Times also stated quite wisely that, "The power to make loans did not necessarily include the power to pay them."⁸

In the issues of December 15, 1838 and March 5, 1839, the Times questioned the constitutional power of the individual American States to contract loans and directly cautioned the British investors against purchasing such bonds.

"The state loans depend upon banking projects and internal improvements, of which probably, not one in ten, for years to come will pay its own expenses, especially in the remoter states."⁹

Several other papers¹⁰ and pamphlets¹¹ warned their readers about the possibilities of repudiation by various state legislatures. But the Circular to Bankers and the Morning Chronicle both urged British investors to place their surplus capital in American enterprises. The Morning Chronicle stated:

"We feel convinced that persons desirous of investing money in any of the principal American securities will find on inquiry that we have never over-rated the honor and good faith which have always been shown by the United States to her creditors."¹²

⁸ Mc Grane, R., op.cit., p.23.

⁹ Ibid., p.19.

¹⁰ Ibid., p.31. The Globe of January 3, 1841 referred to the doctrine of repudiation that was sweeping the country. The Niles Register of January 16, 1841 denied that any

Note the inference of backing by the United States government, a point which will be considered shortly.

McGrane states that it was not difficult to induce European investors to purchase American bonds and stocks because there was an abundance of idle funds in the London money market and money could be borrowed in Europe at 5% while in America the rates were 7 % or 8 %. He also claims that, aside from the higher interest rates, the British were tired of seeing "their accumulated capital wasted in powder and shot, as was the case with many loans to foreign countries".¹³

Elsewhere it is also stated that,

"...the bonds of the several States were therefore easily disposed of in foreign markets, until in 1842 their aggregate debt had swollen to the enormous total of \$213,000,000, an increase of more than 1500% since 1830."¹⁴

4. There was unwillingness on the part of a successor administration of a State to recognize the contractual rights which had arisen between the State and bondholders during the course of previous administrations.

This cause was a common one among the States which exercised repudiation after the so-called "Carpet-Bag" governments lost control and the State governments once state would violate its plighted word.

11 Ibid., p.23. "Junius" Pamphlets. "A Reply to Webster" by Junius, published in Philadelphia by C.J. Ingersoll, Date ?.

12 Ibid., p.19. Morning Chronicle, Feb.19, 1839; Apr.23, 1840.

again were controlled by "natives". The reluctance to honor debts incurred during the "Reconstruction Era" was supposedly based on the theory that debts forced upon the States by "outsiders" did not bind the native inhabitants. But the first wave of repudiations long before the Civil War showed that the natives of many of these States were agreeable to plans for the repudiation of debts regardless of whether the legislatures were composed of "carpetbaggers" or "natives".

5. There seems to be a psychological belief that governments are good credit risks.

Dr. Winkler phrased this quite well when he said,

"Since time immemorial the State appears to have been the most popular debtor. Its ability and capacity to meet payments were always regarded as superior to those of individuals or private corporations."¹⁵

"Ever since borrowing has been in vogue, governments have been looked upon as preferred credit risks. 'Negocio com o Governo' is to this day the most profitable occupation in Brazil. It is not less profitable in the United States or any of its political subdivisions."¹⁶

This is, of course, related to the cause referred to as "Speculation", but it seems of sufficient importance to list separately. For some reason, even conservative

13 McGrane, R., op.cit., p.8.

14 New International Encyclopedia, op.cit., p.717.

15 Winkler, M., op.cit., p.11.

16 Ibid, p.15.

investors have strong tendencies to look upon government bonds as good risks, evidently, just because the name of a State or nation appears on the face of the bonds.

Respect for the stability of government authority seems to have colored the evaluation of these States as credit risks. An investigation of the facts surrounding most of the repudiated bonds at the time of issuance would certainly have saved potential investors the sums they lost.

6. There was an inference that the United States government stood in back of the State bonds because (1) the relationship of sovereign State within sovereign nation was not understood in Europe, (2) the United States government invested in State bonds rather than investigating them, and (3) the United States government did not notify officially the governments whose nationals were investing in State bonds of the national government's inability to guarantee State bonds, based on an inability to interfere in the conduct of State finances.

The fact has been stated that the investors in the bonds of the States which practiced repudiation were not cautious enough. Investigation of the circumstances surrounding the various issues should have been made. But it is also true that there was much recent history at the time which created favorable attitudes towards the States from a credit standpoint.

The national government had assumed all the existing State debts in 1790. This action was said to be based on

justice, on the ground that the States had incurred the debts in the prosecution of the Revolutionary War, and on the reasoning that it was a method of strengthening the central government. After that, the States were comparatively free from liabilities for a period upwards of thirty years, even though the War of 1812 had intervened. The estimated debt of all the States in 1830 was only \$13,000,000.¹⁷ It will also be remembered that the Federal government had so much of a surplus in the mid 1830's that it was apportioned among the States. Therefore, there was some reason for observers' believing a relationship existed between the finances of the national government and those of the States.

English investors had been quite successful in their investments in the stocks of the First and Second United States Banks.¹⁸

Thus it is understandable why Europeans, who did not know the beginning and end of State and federal governmental activities, would be quite willing to invest in bonds issued supposedly to aid construction of railroads, canals, and banks in a new country that had established a fine financial record. American merchants had been prompt in paying private obligations and the United States

¹⁷ New International Encyclopedia, op.cit., p.717.

¹⁸ McGrane, R., op.cit., p.9.

Bank had a reputation for stability abroad.¹⁹ The endorsement of a bond issue by the United States Bank practically insured the success of the issue.²⁰

Around 1838, the agent of the North American Trust and Banking Company sent the charter of the Real Estate Bank of Arkansas to Huth & Company. The charter was accompanied by statistical data and certificates from the War and Treasury Departments of the United States which testified the confidence of these departments by their actual investments in the bonds of Arkansas. It was said that this investment by the United States government proved that the security of "even the newest and smallest state, Arkansas, for instance", was satisfactory to the national government.²¹

¹⁹ Ibid., p.18.

²⁰ See Ibid., p.18.

²¹ Ibid., p.18,19.

Chapter III.

Instances of State Debt Repudiation

Alabama:

Although Fenn, in describing Alabama's debts as of October, 1886, makes no reference to repudiation,¹ Alabama appears on several lists of states which are still repudiating debts.² The Alabama Railway Loans have \$4,700,000 outstanding, according to Winkler who computed the interest in arrears at \$15,745,000.³

William Amasa Scott's The Repudiation of State Debts, which is used officially by the Office of the Secretary of the Treasury, traces Alabama's financial difficulties back to the adoption of its first Constitution on July 5, 1819. In that Constitution, there was an authorization for the establishment of a State Bank with 2/5 of the bank stock reserved for the State.³

The first results of the banking venture were so good, several branches were started. By 1836 the income from the State Bank bonds was sufficient to cover the expenses of the State. Taxes were suspended. Yet the following year these same banks stopped specie payments. Heavy taxation followed in an attempt to honor the bonds of banks which were placed in

1 Nash, R.L., ed., Fenn's Compendium, London, (1889), 14th Ed., p. 642.

2 Winkler, op. cit., p. 203; See also Howland and Campbell.

3 The New York Times, June 20, 1926; Also Scott, W.A., The Repudiation of State Debts, New York, (1893), p. 54, 55.

liquidation in 1842.⁴ Scott reports that the principal was reduced to \$3,445,000 and interest paid until January, 1861 in New York and January, 1865 in London.⁵

Despite this experience, starting in 1867 there were several acts passed by the Legislature which provided for the use of the State's credit for the assistance of railroad construction.⁶ The Alabama and Chattanooga Railroad had \$5,000,000 of its bonds endorsed by the State and received \$2,000,000 more in the form of State Bonds. The Montgomery and Eufaula Railroad Co. received \$300,000 of State Bonds. By September 30, 1873, a total of \$18,686,000 of railroad bonds had been endorsed by the State.⁷

Beginning in January, 1871, the Alabama and Chattanooga failed to meet its interest. The State took the road over and lost another \$1,500,000 in attempting to maintain it in operation. The other railroads followed the A. & C.'s example. This forced the Legislature to pass a Funding Act in 1872, declare higher taxes in 1873, and finally to "reduce" the debt by passing an act which provided for the exchange of the old bonds with a new 7% issue. The following year a Commission was appointed to adjust all claims against the State. In 1874 the Legislature also passed a second

⁴ Ibid., p. 54, 55.

⁵ Ibid., p. 54, 55.

⁶ Ibid., p. 57, 58. Also The New York Times, June 20, 1926.

⁷ Scott, W. A., op. cit., p. 58.

act to "reduce" the debt by specifying certain omissions and changes to be made in honoring the bonds of the State in the future. The effects of these acts were shown in the recapitulation included in the Alabama Repudiation Act (as Campbell⁸ called it) or the Funding Act of 1876⁹ (as the Legislature called it). Scott quotes the Act wherein the Old Debt amounted to \$25,464,470, plus interest, and the New Authorized Debt was set at \$12,574,379.¹⁰ Thus, approximately \$15,000,000 of the debt vanished in repudiation.

Arkansas:

In 1889, Fenn's Compendium commented on Arkansas thus:

"The debt of this State is repudiated or in default. The State Supreme Court have decided that the Levee Bonds (\$2,000,000) are invalid. Except on the secured Sinking Fund Bonds (Loughborough), issued in 1874, the State is in default on all this debt."¹¹

Exclusive of the Levee Bonds in amount of \$427,000, due in 1905, the total of this debt was \$10,458,000.¹²

There appears to be considerable disagreement as to the amount repudiated by this State. Arkansas Railway Loans are listed in amount of \$7,900,000 outstanding and \$22,515,000 interest in arrears by Dr. Winkler.¹³ Another estimate for the total railroad and levee bonds repudiated is

⁸ Campbell, A.J., op.cit., p.85.

⁹ Scott, W.A., op.cit. p.59. Funding Act, Laws of Alabama for 1875-76, p.130.

¹⁰ Ibid., p.63.

¹¹ Nash, R.L., op.cit., p.643.

¹² Ibid., p.643

\$8,700,000.¹⁴

There are also different versions of the date of repudiation. One report has it that charges of fraud and illegality led to a declaration that these bonds were invalid in 1877.¹⁵ Campbell refers to the Arkansas Repudiation Act of 1884.¹⁶ However, Turner relates that under Governor T.J. Terral, the bonds were repudiated by an amendment to the State Constitution of 1874. It was Amendment Number 1 - Article XX. It was adopted January 14, 1885 by a vote of 119,806 to 15,492. No reason was given for the repudiation.¹⁷

Aside from the technicalities of dates, there is agreement on the existence of irregularity in the handling of these bonds. Mc Grane found the following in the Huth & Co. Mss., written by its Correspondent Anderson on October 7, 1843,

"In Arkansas not more than 20,000 of her 90,000 of population have any property to tax...more than one half of this 20,000 (were indebted) to the banks that were founded with the money borrowed on the faith of the State."¹⁸

Hence seven years after this State entered the Union her finances were irretrievably entangled.

Fenn's indicates that the attitude of the State towards

¹⁸ Winkler, M., op.cit., p. 203.

¹⁴ The New York Times, June 20, 1926.

¹⁵ Ibid.

¹⁶ Campbell, A.J., op.cit., p. 85.

¹⁷ Turner, R., "Repudiation of Debts by States of the Union",

her debt had detrimental effects on the State's credit at least two years before the Repudiation Act was passed and some thirteen years before the Amendment was adopted. It is stated that,

"In March, 1872, the Lombard Syndicate invited subscriptions in London for a 7% loan for \$2,165,000...principal payable in 1900... The money was required for railroad purposes. The coupon due April, 1873 was returned unpaid."¹⁹

As may be gathered from the dates, this instance of repudiation seems to be the best example of one wherein everyone who participated was contributing negligence. At the very time when other States were publicly exhibiting the plights brought upon them by reckless financing, Arkansas followed the bad example and investors refused to be taught. Scott tells us that this State was scarcely able to meet current expenses even with the surplus distributed to all the States from the Federal treasury at that time.²⁰

In 1837-1838 the State chartered the Bank of the State of Arkansas and the Real Estate Bank and issued bonds for these banks in amount of \$2,827,000.²¹ The Real Estate Bank bonds, due in 1861, and the State Bank bonds,

Current History, January, 1926.

18 McGrane, R.C., op.cit., p.39.

19 Nash, R.L., op.cit., p.643.

20 Scott, W.A., op.cit., p.119.

21 Ibid.

due in 1868, both suffered default and by 1869 the bond issues plus interest for which the State was liable amounted to \$4,225,000. Just like the other states, Arkansas then had a Funding Act of April 6, 1869 and issued new bonds in place of the old ones.²²

Then, the very same Legislature that passed the Funding Act authorized the loan of the State's credit for railroad construction. Railroad bonds totalling \$5,300,000 were issued. In 1873, the railroads thus aided defaulted like the banks had just five years previous. In 1874, as the railroads were passing into the hands of receivers, the Legislature passed another law which repealed the first railroad law to the extent of eliminating the necessity for the roads to go through receivership.²³ Hence, the original owners came back to control over property that they had totally mismanaged and that they did not, in fact, have any color of legal title therein.

At about the same time that the railroad bonds were issued, the State also issued approximately \$2,000,000 in Levee Bonds.²⁴ As early as 1872 it had been publicly stated that these bond issues were illegal. Five years later the Circuit Court of Little Rock held that the railroad aid

²² Ibid., p. 120.

²³ Ibid., p. 120, 121.

²⁴ Ibid., p. 124.

bonds were unconstitutional and thus null and void. The State Supreme Court (31 Arkansas 701, June, 1877) affirmed the decision. In 1878 the Levee Bonds of 1869 and 1870 met the same fate because it was determined that there had been a technical error in the procedure used for polling the will of the people concerning the loan of the State's credit.²⁵

And so Arkansas, though arriving on the scene after the other States, quickly finished her era of reckless financing by reaching a new high in legal technicalities interpreted for her own benefit!

Florida:

The State Motto of Florida is "In God We Trust".

Much of Florida's financial trouble occurred while it had the status of a Territory. And this was due in large measure to the fact that, as a Territory, it followed the bad example of the nearby States.

Florida entered the Union on Mar. 3, 1845 and thereupon assumed that it was absolved from all the liabilities it had incurred as a Territory -- another lesson in early American legal theory. Scott says,²⁶ "Florida entered the

²⁵ Ibid., p. 124.

²⁶ Ibid., p. 47.

Union as a State adhering to the doctrine that her new form of political life released her from these obligations".

It has been said that some \$8,000,000 of debt had been accumulated prior to 1845.²⁷ Part of this was due to the raising of capital for the Union Bank of Florida in 1833. When this bank failed in 1842, it was decided that the Territory's Council had exceeded its authority in the issuance of these bonds. It was reasoned, therefore, that the bonds did not have to be redeemed. About \$3,900,000 in bonds had been issued for the support of banks.²⁸

Colonel Gamble, President of the Union Bank of Florida, had assured Hope & Co. that the economic possibilities of Florida were unsurpassed and that Congress had tacitly recognized the authority of the territorial legislature of Florida to issue the bonds.²⁹ However, McGrane tells us that the following appeared in the "Floridian" of March 14, 1840:

"Well, who cares if they (the foreign capitalists) don't (loan us any more)?

"We are now as a community heels over head in debt and can scarcely pay the interest."³⁰

In 1855 the railroads which had been assisted by the issuance of State bonds defaulted. Ingeniously, the bonds

²⁷ The New York Times, June 20, 1926.

²⁸ Scott, W.A., op.cit., p. 43, 44.

²⁹ McGrane, R., op.cit., p. 18.

³⁰ Ibid., p. 39, 40.

were then declared invalid because the Florida Constitution did not authorize the exchange of State bonds for railway mortgage bonds. The Florida Constitution had made it the "duty of the General Assembly...to ascertain by law proper objects of improvements"³¹ The Legislature had stretched this to include the financing of privately controlled railroads.

Fenn's makes this statement about Florida,

"Florida is returned as possessing a small State debt, but there were other items, including a railroad loan for \$4,000,000 which the State Courts adjudged not to be binding.

"In December, 1870, Florida effected an arrangement with the holders of her Treasury Bonds, which had been repudiated for some years. A small amount in cash and some extensive land appropriations were thus to have been distributed. This arrangement between the Government and the Council of Foreign Bondholders not having been ratified by the Legislature, the bondholders retained the sum of £ 4 per bond, paid them in consideration of their provisional assent, thereby benefiting to that extent."³²

The Seventy First Annual Report of the Council of the Corporation of Foreign Bondholders has Florida listed as follows:

" "The majority of the Bonds of the following debts defaulted and repudiated before the Civil War are held in Europe:
6% Florida Union Bank Bonds, 1835-8
Amount Outstanding-Approx. \$2,000,000, Principal."³³

³¹ Scott, W.A., op.cit., p. 50, 51.

³² Nash, R.L., op.cit., p. 644.

³³ Council of the Corporation of Foreign Bondholders, 71st Annual Report, London, p. 284.

Dr. Winkler has estimated the amount outstanding as \$7,900,000 and the interest in arrears as \$28,380,000.³⁴ Scott agrees on the amount of the principal.³⁵

However, "Moody's Governments and Municipals of 1946" listed:

"Florida: On October 1, 1945, State of Florida had no recognized bonded debt. However, state funds are being used to service a considerable volume of original debts of local governments."

Georgia:

A most amusing incident, in the light of what was to come, occurred shortly before the Florida Legislature passed its 1843 Repudiation Act. The Georgia Legislature passed and sent to the Governor of Florida resolutions which declared,

"that there is a moral obligation upon every government to discharge its pecuniary obligations, and any state refusing to do so, or to provide the means of payment, is false to the principles of common honesty, and an enlightened civilization, and is unworthy of the confidence of its sister states."³⁶

But the Florida Legislature considered it inexpedient to take any notice of these resolutions.³⁷ Unfortunately, even the advisor did not heed this advice.

³⁴ Winkler, M., op. cit., p. 203.

³⁵ Scott, W. A., op. cit., p. 54.

³⁶ McGrane, R., op. cit., p. 243. (Quotation from "Florida Senate Journal", 1843, p. 64.)

³⁷ Ibid.

Georgia granted \$30,000,000 aid to thirty-seven railroads during the period 1866 to 1870. There ~~was~~ an estimated million dollar investment in the Atlantic & Gulf Railroad, alone.³⁸

Dr. Winkler sets the amount outstanding of the Georgia Railway Loans at \$14,152,000, with the interest in arrears at \$40,797,200.³⁹

Two bond issues, in January and September of 1871, which totalled \$2,400,000 were in peril of repudiation, but, after some delays they were finally recognized. In December of 1871, a notice in regard to these bonds was issued which said that the bonds, circulated by the late Governor, had to a large extent been "illegally and fraudulently issued and negotiated".⁴⁰

The Legislature passed three Repudiation Acts in quick succession, 1872, 1875, and 1876.⁴¹ Governor Clifford M. Walker said that the debts were repudiated because they were contracted by criminals and not in the interest of the State.⁴²

In 1877, the Legislature approved and the people ratified an amendment to the Georgia Constitution which provided that the General Assembly should have no authority to appropriate

38 McGrane, R., op. cit., p. 306. Also The New York Times, June 20, 1926.

39 Winkler, M., op. cit., p. 203. McGrane states, "The minimum face value of the repudiated bonds of Georgia, exclusive of interest, is estimated at \$9,352,000"., op. cit., p. 311.

40 Nash, R. L., Fenn's, op. cit., p. 644, 5.

41 Campbell, A., op. cit., p. 85.

42 Turner, R., Current History, op. cit.

money for paying principal or interest upon obligations pronounced null and void by the Repudiation Acts.⁴³ This action was based on the fact that former Governor Rufus B. Bullock, a New Yorker, had combined with Hannibal I. Kimball, a railroad promoter, to drain the public treasury through the illegal issuance of bonds for the Bainbridge, Cuthbert and Columbus Railroad, the Cartersville & Van Wert Railroad, the Cherokee Railroad, and the executive mansion in Atlanta.

According to Fenn's Compendium, the Georgia debt in 1887 was \$8,210,000.⁴⁴

Louisiana:

"But the climax was reached in Louisiana, where in a single year, the state debt was increased fourfold and the local debt twofold, while in four years' time the total state and city indebtedness was rolled up by the sum of \$54,000,000 all of which went to the spoilers, and nothing to permanent improvements."

-- Lord Bryce⁴⁵

In order to care for the growing business needs of her people, Louisiana started a system of land banks in 1824. The State took one half of the \$4,000,000 capital stock of the Bank of Louisiana. The State also participated to a great extent in the financing of the Consolidated

⁴³ The New York Times, June 20, 1926.

⁴⁴ Nash, R.L., op.cit., p.645.

⁴⁵ The Christian Science Monitor, April 10, 1925, (Quotation from The American Commonwealth, Vol.II, p.478).+

Association of the Planters of Louisiana in 1828, the Union Bank of 1832, the Citizens Bank in 1833. Despite a cautious attitude by European bankers, investors were anxious to buy these Louisiana bonds.⁴⁶ But, in company with most of the banks, the suspension of specie payment by the Louisiana banks in the depressed period 1837-39 signalled the beginning of trouble.

In December of 1842, Louisiana defaulted on the interest payments of the State property bank bonds.

By a Legislative Act of April 5, 1843 the State bonds held by a stockholder of a bank in liquidation could be exchanged for certificates. Thus the stockholders' property, which had formerly been mortgaged to secure the stock, could be freed from mortgage since the new certificates were not secured by mortgage nor by the faith of the state.⁴⁷ This was considered a device by which domestic investors were favored over foreign investors and it drew much protest from foreign bankers. Various prudent measures were pursued by the State in an attempt to honor all just due debts, but the Civil War came when there was still \$5,398,533.33 of property bank bonds among the liabilities of the State.⁴⁸

⁴⁶ McGrane, R., op.cit., p.168-176.

⁴⁷ Ibid., p.183.

⁴⁸ Ibid., p.192.

During the Civil War and the Reconstruction Era, the credit of Louisiana was ruined. Both the military autocracy and the carpetbag government share the blame. No taxes were collected between 1860 and 1874. In 1868 Louisiana State bonds were selling 47¢ on the dollar and levee bonds were wavering between 25 and 30¢. In the same year 26-year old Governor Warmoth started an administration clearly characterized by corruption. Despite the ratification of an amendment to the State constitution in 1870 which provided for a limitation on the debt of the State, State aid was poured into railroads, waterways, and levees which were built mostly in the minds of their promoters.⁴⁹

Under the administration of Governor Kellogg who was supposedly foisted on the State by the Federal authorities, a funding act was passed by the legislature on January 24, 1874. A board of liquidation was established which issued "consolidated bonds of the State" in amount of the newly decreed \$15,000,000 debt limit set by a constitutional amendment. The debt had been estimated at \$53,000,000. At the next election the people ratified the action which, in effect, cancelled some \$38,000,000 of the State debt.⁵⁰

⁴⁹ Ibid., p. 312-316.

⁵⁰ Ibid., p. 317-322.

Campbell refers to this as the "Scale Down Settlement" and Repudiation Act of 1874.⁵¹

Fenn's Compendium relates that the debt of Louisiana was contracted mainly for the construction of levees and other improvements and in January, 1886 amounted to \$15,000,000. In June, 1882, the Louisiana Legislature passed another Constitutional Amendment which again renovated the interest on outstanding bonds.⁵²

The amount outstanding on the Louisiana Railway and Settlement Loans is estimated by Dr. Winkler as \$22,000,000, with an additional \$39,820,000 as the interest in arrears.⁵³

Mississippi:

"It was in Mississippi that the word 'repudiation' came into use in a message by Governor McNutt of that State suggesting the plan of 'repudiating the sale of certain of the State bonds on account of fraud and illegality'."⁵⁴

Mississippi entered the Union the latter part of 1817. Even though other States have exceeded Mississippi in the amounts repudiated, no State outranks her in publicity about her repudiated debts. Campbell claims Mississippi defaulted twice, once in 1842 and again in 1852.⁵⁵

51 Campbell, A.J., op. cit., p. 85.

52 Nash, R., op. cit., p. 645.

53 Winkler, M., op. cit., p. 203.

54 New International Encyclopedia, op. cit., p. 717.

55 Campbell, A.J., op. cit., p. 88.

Dr. Winkler estimates the amount outstanding of the Mississippi Bank Loans as \$7,000,000 with \$37,120,000 interest in arrears.⁵⁶ On his chart, this makes Mississippi the fourth largest among the repudiators.

Scott breaks down the \$7,000,000 outstanding; \$5,000,000 for bonds issued in June of 1838 in payment of 5,000 shares of stock in the Union Bank of Mississippi which failed and \$2,000,000 for Planters' Bank bonds which were purchased by the State by issuing \$500,000 in bonds in July, 1831 and \$1,500,000 more in March, 1832.⁵⁷

The State chartered the Mississippi Union Bank in 1838 with a capitalization of \$15,500,000 and pledged the faith of the State "for the security of the capital and interest".⁵⁸ The bank was almost immediately subjected to "reckless management and the security of the State became worthless, the State found itself saddled with a debt from whose expenditure it had had no benefit."⁵⁹

The Planters' Bank had been justified on the ground that the withdrawal of the branch of the United States Bank would leave the State with a banking capital admittedly insufficient to carry on the marketing of cotton crops. Thus, to aid the planters in disposing of their

⁵⁶ Winkler, M., op.cit., p. 203.

⁵⁷ Scott, W.A., op.cit., p. 33, 43.

⁵⁸ A Member of the Boston Bar, An Account of the Origin of the Mississippi Doctrine of Repudiation, 1842.

⁵⁹ New International Encyclopedia, op.cit., p. 717.

crops, Mississippi joined many of the Southern States in chartering land banks wherein the stock was subscribed by planters and secured by mortgages on their estates while the working capital was procured by issuing State bonds or guaranteeing bonds issued by banks.⁶⁰

McGrane refers to meetings held as early as 1841 for the purpose of advocating repudiation. Governor Alexander McNutt openly declared himself in favor of repudiation in that year because he claimed the act under which the bonds were bought was not in conformity with the State Constitution.⁶¹ But the legislature branded this suggestion of repudiation as a "calumny upon the justice, honor, and dignity of the State".⁶² Successive governors urged the payment of these bonds but no provision was made for the purpose until 1852, when a proposition to levy a tax to pay the bonds and interest was submitted to the people and defeated at the polls.⁶³

Some of the people of Mississippi had moved to Texas to evade the debt.⁶⁴ In 1852 Governor Tucker was elected on a repudiation platform by a vote of 19,059 to D.O. Shattuck's 16,773.⁶⁵ When repudiation came, the report of the State Treasurer showed a balance of 34¢ cash in the trea-

⁶⁰ McGrane, R., op. cit., p. 6.

⁶¹ Ibid., p. 31, 33.

⁶² New International Encyclopedia, op. cit., p. 717.

⁶³ Ibid., p. 717.

⁶⁴ McGrane, R., op. cit., p. 39.

⁶⁵ Rowland, Dunbar, History of Mississippi, Vol. I, 1925, p. 624.

sury along with receipts for claims upon broken banks and notes of insolvent railroad companies.⁶⁶

The feature which probably distinguishes most the Mississippi instance of repudiation from all the others is the fact that the highest court of the State acknowledged the validity of the bonds.⁶⁷ A decision in a lower court which gave judgment for the principal and interest against the State of Mississippi in favor of Hezron A. Johnson was confirmed on appeal. Mississippi refused to meet this judgment of her own higher courts.⁶⁸ The court held that the irregularities in the issuance of the bonds were not so material as to invalidate the bonds.⁶⁹

Then in 1875 a clause was placed in the State Constitution which forbade the State to make payment on these bonds.⁷⁰

In 1930 ~~the~~ Council of Foreign Bondholders at London worked through the Hague Court in an attempt to get payment on the Mississippi bonds.⁷¹ In the same year there was a rather novel action on the international scene when Kinnear & Falconer, solicitors of Stonehaven, Scotland,

66 McGrane, R., op.cit., p.39.

67 The Literary Digest, "Monaco v. Mississippi", Dec.30, 1933, p.9. (Places date as 1851).

68 The Christian Science Monitor, "Scots Petition Congress on Mississippi Bonds", March 13, 1930. (Places date as 1852).

petitioned Congress to reprimand the State of Mississippi for refusing to redeem her bonds.⁷²

The annual report of the Council in 1943⁷³ listed a subcommittee named "State of Mississippi--U.S.A. Committee". The 1944 report gave a brief description of the attempted suit of the State by the Principality of Monaco. This was the first foreign country to act under the clause of the Federal Constitution giving our Supreme Court jurisdiction over controversies between American States and foreign countries.⁷⁴ The statement ended with,

"1934- On the 21st May the Supreme Court gave judgment that the application of the Principality of Monaco for leave to sue the State of Mississippi in respect of repudiated Planters' Bank and Union Bank Bonds must be denied. This opinion was in substance based upon the contention that it was contrary to the intention of the Federal Constitution that a State of the Union should be sued by a Foreign State without the former's consent. The refusal of the application to sue, therefore, prevented the hearing of the actual facts of the case. The right of the States of the Union to sue each other without consent was confirmed."⁷⁵

Under the caption, "United States of America, Defaulted Debts of States of the Union", the following listing appeared in the same report,

69 New International Encyclopedia, op.cit., p.717.

70 The Literary Digest, op.cit., p.9.

71 O'Toole, R.F., "Mississippi Pledges Her Faith", American Mercury, December, 1930.

72 The Christian Science Monitor, op.cit., March 13, 1930.

73 70th Annual Report of the Council of the Corporation of Foreign Bondholders, p.282.

Approximate Principal Amount Out-
Standing

Mississippi	6% Planters' Bank Bonds, 1831-3.	\$1,912,000
	5% Mississippi Union Bank Bonds, 1838.	5,000,000 ⁽⁷⁶⁾

Since the Monaco suit, the usual annual report of the Council reads,

"U.S.A.-Mississippi

There have been no developments during the year of special interest to holders of the external obligations of the State of Mississippi."⁷⁷

North Carolina:

Lord Bryce spoke of North Carolina as a State that issued \$14,000,000 worth of railroad bonds and then made no railway.⁷⁸ This State is listed by Dr. Winkler as the third largest repudiator, with \$13,886,030, amount outstanding and \$40,428,605, interest in arrears.⁷⁹ The amount has also been listed as \$12,805,000 in bonds issued to six railroads with the stock in the railroads given as security.⁸⁰ Still another source claims \$13,000,000 in bonds was issued for the construction of railroads and a

⁷⁴ The Literary Digest, op. cit., p. 9.

⁷⁵ 71st Annual Report of the Council of the Corporation of Foreign Bondholders, p. 284.

⁷⁶ Ibid, p. 284.

⁷⁷ Ibid, p. 48. (Year 1944); also 72nd Annual Report, p. 45.

state penitentiary.⁸¹

In the period 1848-1858 the State contracted a bonded debt when it extended public aid for the building of plank roads and canals. During the Civil War the State issued about \$1,128,000 in bonds for purposes not connected with the war. A large number of these were payable in Confederate money. Because these bonds had no market value, the State never recognized them.⁸²

In 1857 North Carolina borrowed \$250,000 and put up North Carolina Railroad Company stock as collateral. Later, when the State sought to discharge this obligation by paying 25¢ on the dollar, dissatisfied bondholders donated \$27,000 of bonds to the State of South Dakota which sued North Carolina in the United States Supreme Court during 1904 and won.⁸³

By the Funding Acts of March 10, 1866 and August 20, 1866, bond issues of a total of \$4,138,800 were sold to meet overdue bonds and coupons. Still other bonds in aid of railways and for the Literary Fund were issued after the Civil War, but by virtue of pre-war statutes. These totalled \$5,992,600.⁸⁴

78 The Christian Science Monitor, April 10, 1925, quoting Lord Bryce's statement in The American Commonwealth, Vol. II, p. 478.

79 Winkler, M., op. cit., p. 203.

80 Randolph, B., op. cit., p. 64.

81 The New York Times, June 20, 1926.

82 Randolph, B., op. cit., p. 64.

83 Private records of E. F. Barry, Boston representative of

The famous "Special Tax Bonds", which have been mentioned before in the discussion of the Republic of Cuba vs. North Carolina were issued after the adoption of the new Constitution of April, 1868, which forbade the issuance of any bonds unless provision for interest payments was made by levies of definite taxes for the purpose.⁸⁵ At the time of the suit which was withdrawn by Cuban Presidential decree on January 4, 1917, North Carolina claimed that the bonds had been issued by a "ring of unprincipled adventurers and carpetbaggers illegally and fraudulently". The withdrawal of the suit was taken as an acknowledgement that the bonds were illegally issued.⁸⁶

The "Scale Down Settlement" or Repudiation Act occurred in 1879.⁸⁷

Governor A.W. McLean contended that there was no legal or moral obligation upon the State of North Carolina in respect to the bonds mentioned.⁸⁸ The Federal Government held some of the repudiated North Carolina bonds.⁸⁹

The fact that during 1921-1926 North Carolina issued 145 millions in bonds without difficulty is offered as proof that the credit of the State is as good as that of

⁸³ cont.- the Council of Foreign Bondholders, London.

⁸⁴ Randolph, B., op. cit., p. 64.

⁸⁵ Ibid., p. 64.

⁸⁶ See Turner, R., op. cit., Reply of Governor A.W. McLean of North Carolina.

⁸⁷ Campbell, A.J.; op. cit., p. 85.

⁸⁸ See Note 86.

⁸⁹ The Christian Science Monitor, J.P. Cooper's Letter to

any other State and unharmed by its action of repudiation.⁹⁰

Although Fenn's Compendium is of no help in giving details about the repudiated debts of this State, the following summary is a comment on the effects of repudiation,

"Years ago the credit of this State stood high; but it was after the Civil War almost wholly destroyed by improvident legislation. The Funding Law of March, 1879, provided for funding old Ante-War Bonds at 40% of their face value, new Railroad Bonds at 25%, and 1866 and 1868 Bonds at 15%, nothing being received for overdue coupons. Coupons of the new bonds are receivable for taxes. Special Tax Bonds, Railroad Bonds, not fundable, and Penitentiary Bonds are ignored. The debt now mainly consists of Consolidated 4%'s redeemable in 1910, and 6%'s, redeemable in 1919."⁹¹

South Carolina:

South Carolina, which entered the Union in 1788, suffered the effects of the repudiations of other States long before it became involved in financial difficulty itself. Although the State had been punctual in meeting its payments, its stocks were selling in London below par in 1841.⁹²

In 1868 and 1869 South Carolina authorized loans to redeem the previous indebtedness of the State and to assist the Blue Ridge Railroad Company. Following an investigation

the Editor, May 20, 1925.

90 See Note 86.

91 Nash, R.L., op.cit., p.650.

92 McGrane, R., op.cit., p.36.

of corruption there was an exchange issue of bonds which omitted about six million dollars of the old bonds.⁹³

In one four-year period the State debt leaped from \$5,407,000 to \$18,515,000 during the administration of Governor Moses.⁹⁴

South Carolina is said to have \$7,500,000 outstanding in bonds which she currently refuses to recognize. There is more than \$25,005,000 interest in arrears.⁹⁵

Campbell refers to South Carolina's Repudiation Act of 1873 and its "Scale Down Settlement" of 1879.⁹⁶

Fenn's Compendium has this to say about South Carolina:⁹⁷

"Debt in November, 1885, \$6,522,000.

"The Funding Law of the 23rd December, 1873, provided for the reduction of all the old debts by 50%. The Consols then created were again "readjusted" in 1879. In November, 1881, the Consols stood at \$5,336,104."

Other States:

Illinois:

In 1837, the Illinois Legislature authorized the borrowing of \$8,000,000 to establish a general system of internal improvements after the State had received a federal land grant for the construction of the Illinois

⁹³ The New York Times, April 20, 1926.

⁹⁴ The Christian Science Monitor, April 10, 1925.

⁹⁵ Winkler, M., op. cit., p. 203.

⁹⁶ Campbell, A. J., op. cit., p. 85.

⁹⁷ Nash, R. L., op. cit., p. 651.

and Michigan Canal.⁹⁸

Following the Panic the payment of accruing interest was suspended. Although there were meetings held which advocated repudiation in 1841,⁹⁹ the crisis passed without the repudiation of the capital of the debt.¹⁰⁰

Indiana:

Although some element of irregularity has been noted in regard to the negotiators of Indiana bonds who received numerous favors in the way of stock and commissions from the Morris Canal and Banking Company,¹⁰¹ it is reported that no part of the capital debt of the State was repudiated. The State did, however, suspend the payment of accruing interest in the period following the 1837 Panic.¹⁰²

Maryland:

Maryland was another of the States which found it necessary to suspend the payment of accruing interest because of the impact of the 1837 Panic.¹⁰³

Michigan:

A review of some of the facts leaves a con-

⁹⁸ McGrane, R., op.cit., p.6.

⁹⁹ Ibid., p.31.

¹⁰⁰ New International Encyclopedia, op.cit., p.717.

¹⁰¹ McGrane, R., op.cit., p.8.

¹⁰² New International Encyclopedia, op.cit., p.717.

¹⁰³ Ibid.

siderable doubt as to whether the incident which is referred to as the "Scale Down Settlement" of 1842¹⁰⁴ is sufficient basis for including this State among the instances of repudiation.

According to the Michigan Constitution, the Legislature was given the duty of encouraging the construction of public works. It seems that the legislature took its duty so much to heart that it voted a loan of \$5,000,000 for public works at a time when the population was less than 200,000 and the total assessed value of property less than \$43,000,000.¹⁰⁵ English financiers were quite influential among the members of the legislature.¹⁰⁶

Some Michigan State bonds were given to the Morris Canal and Banking Company on credit.¹⁰⁷ The bank was to pay for them on the installment plan. The Bank of Pennsylvania was a surety for the payment of these installments. However, both the Morris Canal and Banking Co. and the Bank of Pennsylvania failed and it was then learned that a large amount of the State bonds, which were only partially paid for by the Canal Company, had been transferred to the Bank of Pennsylvania which had dealt with them in the foreign market. Although the bonds were then

104 Campbell. A.J., op. cit., p.86.

105 McGrane, R., op. cit., p.6.

106 Ibid., p.7.

107 Ibid., p.8. Also New Internat. Encyclop., op. cit., p.717.

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in the hands of innocent foreign holders, the State claimed that it was bound to repay only the money it had actually received and, hence, called for the exchange of the part-paid bonds for new certificates in amount which the State had received, with interest thereon.¹⁰⁸

Admittedly the State was wrong in issuing bonds on credit, but it would appear that the directors of the Bank of Pennsylvania and the Canal Company were primarily liable and, upon the facts, should have been subjected to criminal prosecution.

An excerpt from a book published in 1853 gives an example of corporate methods in Michigan:

"There is now in the State of Michigan a railroad corporation with a bank attached to it but whether intended to be the locomotive or the baggage car, we know not; but it is a very thriving bank, and with \$100,000 capital, has \$93,000 specie in its vaults and enjoys a circulation of \$279,000. The railroad part of the business has not, we believe, yet been commenced but we wish that there were more of such banks in the same state to supplant the circulation of the 'wild-cat' money there."¹⁰⁹

Fenn's has little to say about Michigan,

"In June, 1882, the debt of this State was reduced to \$889,000, or £ 180,000, consisting of \$590,000 in 6% bonds, and \$299,000 in 7% War Bounty Bonds. Interest in both cases is payable in New York. The principal of the 6% issue is redeemable in 1883, and that of the 7% issue in 1890."¹¹⁰

¹⁰⁸ New International Encyclopedia, op. cit., p. 717.

¹⁰⁹ Baker, Henry F., Banks and Banking in the United States, Ticknor, Reed and Fields, Boston, 1853, p. 50.

¹¹⁰ Nash, R. L., op. cit., p. 647.

Minnesota:

When Minnesota entered the Union in May, 1858, there was already some political discussion current concerning the extent of the State's participation in an issue of railroad bonds which the State was guaranteeing. But the dissenters did not have their way and, as a result, in 1880¹¹¹ the State agreed ~~to~~ compromise the payment of certain railroad bonds at 50¢ on the dollar and accrued interest. The justification offered was that the railroads had failed to comply with the conditions of the issue.¹¹²

Fenn's Compendium claims that Minnesota refused to recognize the State Railroad Bonds of 1858 to the amount of \$2,275,000, but that there was a compromise with the holders in 1881 whereby $4\frac{1}{2}\%$ Adjustment Bonds, redeemable in 1912, were issued in amount of \$4,000,000.¹¹³

Pennsylvania:

Fenn's is silent on the irregularities of the Pennsylvania debt. It merely says that the debt was contracted largely " for the construction of an elaborate system of canals, which, however, have lost much of their

¹¹¹ New International Encyclopedia, op.cit., p.718. Campbell, A.J., op.cit., p.86, refers to the Scale Down Settlement of 1881.

¹¹² New International Encyclopedia, op.cit., p.718.

¹¹³ Nash, R.L., op.cit., p.647.

value by the establishment of railways". The amount outstanding was listed as \$19,700,000, with a note, "against this total there is a substantial sinking fund".¹¹⁴

In February, 1840, Pennsylvania delayed in paying her semi-annual dividends, a fact which foreshadowed bad financial conditions throughout the country because Pennsylvania was one of the wealthiest States in the Union.¹¹⁵ Two years later the Bank of Pennsylvania failed and every bank south of Philadelphia suspended payment.¹¹⁶ The obvious wealth of the State made it most difficult for the foreign bondholders to understand the reason for the State's defaulting on its bonds. Some of these investors addressed a letter to the House of Representatives, Washington, D.C., to inquire about this.¹¹⁷

William Wordsworth, whose family had lost heavily by these bonds, expressed his sentiments in two sonnets, "Men of the Western World" (1841) and "To the Pennsylvanians" (1848).¹¹⁸

However, on February 1, 1845, Pennsylvania became the first of the insolvent States to place her finances on a sound basis by resuming interest payments.¹¹⁹

¹¹⁴ Nash, R.L., op.cit., p.650.

¹¹⁵ McGrane, R., op.cit., p.30.

¹¹⁶ New International Encyclopedia, op.cit., p.717.

¹¹⁷ Winkler, M., op.cit., p.9.

¹¹⁸ Randolph, B., op.cit., p.63. Also The Christian Science Monitor, May 1, 1930.

¹¹⁹ McGrane, R., op.cit., p.81.

Tennessee:

According to Fenn's, the State of Tennessee is

"...an old defaulter on a debt considerably exceeding \$20,000,000, the amount lately being returned at \$17,000,000.

"The Funding Bills of 1881 provided for new bonds at 3% to be given for the full nominal value of the old and 12 overdue coupons, including that of July, 1881, but the State Supreme Court held the Law to be unconstitutional. A new Funding Law was passed on the 20th May, 1882, without the tax-receivable coupon clause, and giving new bonds at 6% of the principal and interest of old, the new bonds bearing 3% in 1882-83, 4% in 1884 and 1885, 5% in 1886 and 1887, and 6% in 1888 to 1912."¹²⁰

In his article in 19th Century, Campbell states that Tennessee made "Scale Down Settlements" in 1882 and 1883.¹²¹

Virginia and West Virginia:

In 1847, Prime, Ward & Co. listed Virginia as one of nine States which had regularly paid the interest on their debts.¹²² But by the late 1870's, Virginia joined a list of delinquent states.¹²³ The public debt had been contracted for the purpose of aiding internal improvements. Virginia, in fact, had pioneered in the public financing of such projects.¹²⁴

During the Civil War, the State was forced to stop interest payments on its debt due to the immense loss of property.¹²⁵ When efforts to reunite West Virginia and

¹²⁰ Nash, R.L., op.cit., p. 651.

¹²¹ Campbell, A.J., op.cit., p. 86.

¹²² McGrane, R., op.cit., p. 265.

¹²³ Ibid., p. 282.

¹²⁴ Ibid., p. 364.

¹²⁵ Ibid., p. 365, 367.

Virginia failed in the early months of 1866, the Virginia legislature in March passed an act reducing the interest on the public debt from 6% to 4%. Later, despite State constitutional provisions of both Virginia and West Virginia which acknowledged the proportional liability of the two States for the debt incurred by them while united as Virginia, an agreement for the actual assumption by West Virginia of its proportion could not be reached.¹²⁶ This led to Virginia's acting alone. The Legislature passed the "Funding Act" on March 30, 1871, by which Virginia recognized 2/3 of the total debt. The new bonds issued under this act became the subject of political controversy and the next legislature declared them invalid for the payment of taxes. The panic of 1873 added to the devaluation of these bonds.¹²⁷

In 1874, a "Readjustment" plan was proposed which was, in fact, a plan for repudiation. Following many political maneuverings by the "readjusters"¹²⁸ and the "debt-payers"

¹²⁶ McGrane, R., op. cit. p. 367. Also Scott, W. A., op. cit., p. 167, where it is stated that West Virginia contended that the debt should be divided according to where the public improvements were made rather than according to area and population, because most of the improvements were within the boundaries of the new Virginia.

¹²⁷ McGrane, R., op. cit., p. 367, 370.

¹²⁸ Scott, W. A., op. cit., p. 175, 176, 180, explains that enemies of the Funding Act of 1871 were called "readjusters". Since 1872 the legislature had been in the control of the "readjusters". To this category belonged adherents of both political parties and the struggle up to this

the legislature passed the famous Riddleberger Act on February 14, 1882. This was the definite beginning of "Readjustment" legislation.¹²⁹ The rational plan seemed to be to enter into negotiations with the bondholders with a view to inducing them to accept a lower rate of interest and other terms more favorable to the State. Conferences held before the legislative session of 1879 and correspondence with foreign bondholders and others revealed a willingness on the part of the latter to accept a reasonable compromise.¹³⁰

Finally, in 1892, after much legislation aimed at discouraging bondholders by making the bonds unacceptable for the payment of taxes and after much controversy in the courts, an act was passed which was described as a "final and satisfactory" settlement of the debt. This act embod-

time had been carried on within these party lines. This indicates clearly that public opinion had condemned the Funding Act of 1871. Subsequent legislation supports this view. But it should not be concluded that a majority of the people of Virginia were in favor during these years of cheating the bondholders out of their rightful dues. "Readjusters" included representatives of both views. All who did not belong to the old party were readjusters, and of these we may distinguish two parties, moderates and radicals. Moderates: the State was in duty bound to pay every dollar of her indebtedness, accrued interest as well as principal, but that in view of her misfortunes, the State might with propriety call upon the bondholders to accept a rate of interest considerably lower than that yielded by the consols and the pealers. Radicals: the State was under no obligation to pay the interest that had accrued during the Civil War

ied the Riddleberger Act in principle and provided for the issuance of \$19,000,000 of new bonds in exchange for \$28,000,000 of old bonds.¹³¹

The matter of West Virginia's assumption of her part of the debt took until 1915. The Supreme Court of the United States had taken jurisdiction of the case and after lengthy proceedings handed down a judgment which West Virginia accepted. In 1919 legislative provision was made for the payment of West Virginia's part of the debt.¹³²

Fenn's comments as follows on the Virginia debt,

"British bondholders are, unfortunately, interested in the debt of this State, which in reality amounts to \$45,000,000 although returned at a smaller sum.

"The Virginia five per cent sterling bonds were issued as far back as 1854, and the loan is domiciled with Messrs. Baring Brothers and Co. Unpaid coupons were in 1871 funded, and partial interest was paid until 1874, since when all payments have ceased. The amount outstanding is L 136,952."¹³³

and the period of reconstruction, and that the bondholders ought to be given the alternative of accepting bonds bearing a lower rate of interest and in amount equal to the principal of the debt as it stood at the outbreak of the war, or of submitting to the repudiation of all their claims. H.H.Riddleberger, later U.S. Senator, was the leader of the "Readjusters" and introduced the famous bill which bears his name and which won support of the people of Virginia irrespective of party.

129 McGrane, R., op. cit., p. 372.

130 Scott, W.A., op. cit. p. 177.

131 McGrane, R., op. cit., p. 372.

132 Ibid., p. 380, 381.

133 Nash, R.L., op. cit., p. 651, 652.

Chapter IV.

Effects of State Debt Repudiation

All the effects of State debt repudiation are undoubtedly too numerous to determine, much less to record. However, the effects which are of continuing importance may be summarized as the following:

- (1) The credit of all the States and even the United States has been subjected to a cloud of suspicion, and, in many instances, actually lowered substantially.
- (2) The foreign bondholders became united in their efforts to collect on the repudiated bonds and these efforts still continue.
- (3) The debt repudiations still remain a topic of discussion in International Councils.
- (4) The subject remains a reason for intermittent international dispute.

1. State Credit:

"In the eyes of the civilized world the whole nation was disgraced because certain American states had openly repudiated their obligations and there was danger others might follow example."¹

Author McGrane refers to a "noticeable degree of caution exercised by old conservative banking firms in accepting (American stocks and bonds) for sale to their

clients" during the 1850's. But the high rates of interest carried by the stocks and bonds of American railroads attracted the European investors who wanted to invest.²

It is reported that in 1842 no one in Holland would touch any more American securities unless the federal government would act so as to restore State credit.³

Edward Everett, the United States Minister to England, wrote to Secretary of State Webster on May 6, 1842,

"It would be difficult to obtain subscriptions to a United States Government loan in Europe. Thus would European capitalists impress the national government with the disastrous effects of state repudiation."⁴

On April 21, 1843 the London Times reported that Overend, Gurney and Company of London notified the United States to expect no assistance unless the federal government assumed the debts of the States.⁵ The federal government found it impossible to borrow abroad. This led to proposals in Congress for another assumption of State debts by the national government.⁶

Briefly, the effect of repudiation on State credit has been given thus:

"The inevitable result of repudiation has been that foreign capitalists have learned to discriminate between the values of different State

¹ McGrane, R., op. cit., p. 2.

² Ibid., p. 271, 272.

³ Ibid., p. 33.

⁴ Ibid., p. 31.

⁵ Ibid., p. 33.

securities; and while the bonds of the non-repudiating States, including those Southern States which have not followed the example of their neighbors, command a premium, the bonds of the various repudiating States fluctuate at from 10 to 50 % of their face value."⁷

2. Foreign Bondholders:

It has been estimated that British subjects held between 110 and 165 millions of dollars of American stocks by 1839. The United States Bank of Pennsylvania has been cited as an example of where one-half of the capital stock was held in Europe.⁸

When the repudiation States showed openly their determination not to repay their loans, many of the bondholders in Europe united in their attempt to have their investments honored. Petitions and memorials were prepared by the disappointed investors and sent to the various State and national officials and legislative bodies.⁹

As a result of the repudiations and other irregularities by governments in their financial dealings with nationals of other States, protective measures have been taken by the foreign investors of most countries in the form of the founding of quasi-governmental bodies which

6 Ibid.,p.2.

7 New International Encyclopedia,op.cit.,p.718.

8 McGrane,R.,op.cit.,p.9.

9 Ibid.,p.2.



act as bondholders' protective committees. Dr. Winkler has described these in detail.¹⁰

The Council of Foreign Bondholders of Great Britain, which still mentions the past delinquencies of certain American States in its annual reports,¹¹ was

"...founded in 1868, incorporated in 1873 under license from the Board of Trade, and reconstituted in 1898 by Special Act of Parliament. Under that Act the Council of the Corporation consists of 21 members, of whom six are nominated by the British Bankers' Association, six by the London Chamber of Commerce, and nine are co-opted by the Council as a whole--that is, by the votes of both the representative and the co-opted members. A majority of the members of the Council are thus appointed by independent outside bodies.

"The principal object of the Corporation is the protection of the interests of the holders of foreign securities."¹²

Mr. A. Campbell has said that the task of the Council is "to ventilate" the issue of repudiation. He claims that in 1912 the Council discouraged foreign investments in a small North Carolina loan which was taken by North Carolina's own citizens finally and in 1913 the Council made an attempted Louisiana issue a failure.¹³

3. International Council Topic:

While the Pan American General Arbitration Treaty was pending in the United States Senate, Professor Quincy

¹⁰ Winkler, M., op. cit., Chapter VIII, p. 153-178.

¹¹ McGrane, R., op. cit., p. 3.

¹² Winkler, M., op. cit., p. 153.

¹³ Campbell, A. J., op. cit., p. 88.

Wright pointed to what he called an "important subterranean element" in opposition to it. The Southern Democrats were opposed to any kind of arbitration treaty in view of the fact that the Southern States owed large debts to British subjects. It was said that this opposition would have disappeared if the United States would have assumed the debts.¹⁴

In 1931, the topic was important enough to command editorial space in The Christian Science Monitor. An International Joint Commission, which had been so successful in a number of cases, was proposed for the settlement of the debt question.¹⁵

On January 19, 1935, J. Reuben Clark, president of the Foreign Bondholders Protective Council, the United States counterpart of the Council of Foreign Bondholders, stated that consideration of the repudiated bonds was barred by treaty. Under the Treaty of Washington of 1871, there was no obligation on the part of the United States to honor these debts. Furthermore, the General Claims Commission of the United States and Great Britain, by the Treaties of 1853 and 1910, wiped out all possible claims on these bonds.¹⁶

But this has in no way spelled a definite end to the controversy.

¹⁴ The Christian Science Monitor, "Statement Sought on

4. International Dispute:

At this particular time in world history when the need for achieving the peace is so great, it seems regrettable that so much time and effort has been, and continues to be, devoted to negotiations of settlements of the loans herein discussed, and international loans in general. Immeasurable time which should have gone into constructive international planning has been wasted because of these past acts of certain States.

Dr. Winkler, who has made several studies of the specific effects of default on government bonds says that defaults on governmental obligations affect international trade, tariffs, investments, foreign exchange, the merchant marine, the recognition of governments, inflation, the domestic financial situation, balancing of budgets, and sow the seeds of war and revolution.¹⁷

In 1931 in England, there were two public burnings of the bonds of American states which had repudiated.¹⁸ Certainly, this does not display the existence of favorable international relations.

Caribbean Stand", November 24, 1930.

15 Ibid., Editorial, "International Commissions", Mar. 28, 1931.

16 Ibid., "Council Head Says British Civil War Claims Against (United States) South Are Invalid", Jan. 19, 1935.

17 Winkler, M., op. cit., p. ix.

18 Randolph, Bessie Carter, American Journal of International Law, "Foreign Bondholders and the Repudiated Debts of the Southern States", Vol. 25, No. 1., Jan., 1931.

During the Naval Conference in 1930, Lord Ponsonby rebuked his fellows in the House of Lords who had revived the issue of the 1840 debt repudiations of the southern United States. Lord Redesdale commented that the rebuke was made because of the Naval Conference.¹⁹ But the fact that some English officials have an appreciation for political expediency does not detract from the unpleasant potentialities which the repudiations have left on the international scene.

Somewhat indicative of the legal trend is the tentative proposal for the codification of international law prepared by the Harvard Law School Research Committee for use at the Hague Conference in March and April of 1930. Article 86 of the Section on the Responsibility of States reads:

"A State is not responsible if an injury to an alien results from the non-performance of a contractual obligation which its political subdivision owes to an alien, apart from responsibility because of a denial of justice."²⁰

An example of international prodding on the newspaper editorial level may be cited with the following excerpts:

Financial News of London, April 7, 1925:

"We cannot dismiss the matter of international debt without a further reference to the disgraceful default of eight of the United States., viz., Ala-

¹⁹ The New York Herald Tribune, "Peers Talk Debt Repudiation of Southern States", March 14, 1930. Also The Christian Science Monitor, "Peers Call Old American Loan

bama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, and South Carolina. Collectively they owe £ 14,418,800 and the interest upon the principal, calculated at an average rate of 6% for 50 years reaches the formidable total of £ 46,074,302. 'These States', says the report, 'have not only defaulted on their obligations, but some of them have inserted clauses in their Constitutions forbidding their recognition.' The idea of repudiation by Act of Parliament was, we thought, peculiar to revolutionary juntas, but evidently they manage these things better in America. For our own part, we would like to see this question taken up by our Government with Washington. There is little purpose in caning the small boy if the big boy is permitted to offend with impunity. In a previous report the Council of the Corporation of Foreign Bondholders suggested that a settlement of these long overdue liabilities would be 'a graceful act'. We would go further than that. We would call it an honest act."²¹

The Chicago Tribune, April 18, 1927-(Editorial):

"The British Debt Settlement was negotiated at about 75% of the obligation.

"Let Britain pay in full by notifying British holders of State bonds that their money is in the Bank of England!

"If British pay in full, then the British would be paid in full."²²

Previous to these comments the New York Stock Exchange in the fall of 1924 made a ruling that all foreign governments who might wish to place their bonds on America's principal market should state, among other items of information, their past debt record with respect

Private Affair", March 13, 1930.

20 Randolph, B., op. cit., p. 64.

21 The Christian Science Monitor, April 10, 1925.

22 Editorial, "A New Way With Old Debts".

to defaults, the scaling down of interest payments, and the suspending of interest payments.²³ So America showed some signs of learning from her own lesson.

In 1926 it was reported²⁴ that the discussion of funding the debts owed to the United States by the European nations brought the topic off the southern debts into prominence. Thus, in the course of world court debate, one southern Senator proposed a reservation to prevent these repudiated obligations ever coming before that international tribunal.

The foregoing are but selected examples of the type of actions, a collection of which can be used to initiate international misunderstanding.

²³ Winkler, M., op.cit., p.140.

²⁴ The New York Times, May 17, 1926.

Chapter V.

Conclusions

An examination of the material about State Debt repudiations shows that many of the writers have chosen to deal with general causes or reasons, as applied to a group of States. It is, of course, true that the repudiations occurred in series, such as those of the 1840's, the 1860's, the 1880's. But the panic of 1837, the Civil War, or the panic of 1873 did not have the same effect on all States. That is, all the States did not repudiate their debts. Hence it seems clear that the causes or reasons cannot accurately be given as these widespread disturbances in the national economy.

Rather, for every instance of repudiation, there is a specific case of mismanagement(if that term may be used to include outright dishonesty which was all the worse for not being prosecuted). Investment firms, public officials, those in charge of the banks, the railroads, and the public works were obviously motivated by selfishness. Later administrations gained power by persuading the electorates that there was no moral obligation on the States since the debts were not contracted in the public interest. Electorates endorsed those views to escape taxes and

forgot to demand investigations and prosecutions of the past acts of dishonesty in public life.

The Federal Government failed to realize that nationals of other governments naturally looked to it to stand back of the States and that the national reputation was at stake. When confronted with the necessity for a decision, it was quite easy for the State Department, then, to lecture Englishmen on the unique characteristics of government as it existed within our borders. But, an announcement to this effect, which would have been so diplomatically correct while the bonds were being floated, was not made.

Foreign investors, who have been bemoaning their treatment with international publicity ever since, were "liberal investors" if not actually speculators. Certainly full investigations of the conditions underlying the floating of these bonds would have convinced the prudent investor that there were substantial elements of risk. For instance, several of the southern States had publicly demonstrated repudiation long before the "carpetbaggers" went south.

It does not seem possible that an investor who had made even a preliminary investigation of the population, taxable property, and banking procedures of the States

would have placed his money in the State bonds of the 1830's.

The available facts on the consist of the "carpetbag" legislatures should have placed all wise investors on sufficient notice during the second issuance period. And the enthusiasm of the brokers, the pitiful economic conditions of the States, the slow construction of the railroads, and the past financial history of the States seem to have offered an abundance of stop lights to even the reckless investor during the 1870-1884 period, which Lawrence Chamberlain has characterized as " a period of bad faith".¹

Thus, with malice towards none, let this venture into the why of these repudiations conclude that, with a sizable portion of the evidence considered, all parties to these repudiations were either corrupt or quite reckless with their own funds or those of others.

Conclusion As To Causes:

"While most writers are too prone to apply to public debts the principles of private law and to treat repudiation as state bankruptcy, repudiation does not always involve inability to pay as implied in insolvency and is not infrequently motivated by major considerations of a political and social nature."²

1 Munn, G.G., op.cit., p.695.

2 Encyclopedia of Social Sciences, Vol.XIII, p.321, See "Repudiation".

Conclusion As To Effects:

"Public opinion demands the fulfillment of promises made, especially in regard to the payment of money. A very good reason for this is that if a nation does not pay its debts, it finds difficulty in borrowing money again when it wants it, or, in other words, a desire for further loans generally acts as an inducement to fulfill outstanding obligations.

"The policy of using their influence to prevent subscriptions by advertising the fact that they were in default, and otherwise doing what they could to see that people did not again **loan** them money, was pursued by the Council of Foreign Bondholders with regard to Peru in 1829, North Carolina and Mississippi in 1910 and Louisiana in 1913."³

Conclusion As To Probable Recurrence:

"Perhaps the greatest need in the field of State debts today is intelligent and comprehensive planning and administration. When debts are small, the lack of such features is not fatal, but as the debts increase, careful planning and management become more and more essential. This record of the States' experiences with their debts and the generalizations drawn therefrom should provide some guidance in the formulation and administration of such plans."⁴

"The States only can provide remedies for it. The substantial increase of wealth in all sections of the country affords a guarantee for the future. Another and perhaps more efficient safeguard against its recurrence is to be found in the innumerable restrictions upon the debt-making power of the States which have found their way into recent State constitutions."⁵

³ Winkler, M., op. cit., p. 140.

⁴ Ratchford, B. U., op. cit., p. 240

⁵ The New International Encyclopedia, op. cit., p. 718.

A P P E N D I X

State of Ohio

Frank J. Lausche
Governor

Office of the Governor
Columbus 15

March 23, 1949

Mr. John J. Graham
Attorney at Law
84 State Street
Boston 9, Massachusetts

Dear Mr. Graham:

The Ohio Sportsmen turned over to the Conservation Commission of Ohio bonds having a face value of \$200,000 issued by a carpet-bagger government of the State of North Carolina in 1868. It was expected that the State of Ohio would sue the State of North Carolina on these bonds.

It is reliably reported to me that if a judgment were obtained then private owners of similar bonds would go to the State of North Carolina to drive a settlement under the threat of giving the bonds to other states to bring suit upon them.

I am quite certain that the people of Ohio do not want their State to become a scavenger gorging itself upon the dormant and not dead bonds issued eighty years ago by a sister State. Moreover they do not want their State to become a party to a scheme of aiding private bondholders in attempting to collect on bonds that seemingly have no validity.

Sincerely yours,

(Signed) FRANK J. LAUSCHE

FJL;cmj

Ref. 2123/721A

Tel.:MONarch 97069

COUNCIL OF FOREIGN BONDHOLDERS

17, Moorgate,
London, E.C.2.

23rd May, 1946

John J. Graham, Esq.,
111 Commonwealth Avenue
Boston 16, Massachusetts

Dear Sir:

I have to acknowledge your letter of the 10th May on the subject of defaulted debts of certain Southern States of the U.S.A.

The Council have made a particularly close study of the debts of the State of Mississippi, to which detailed references were made in many of the Council's Annual Reports from the year 1907 onwards. You would probably find these Reports in the Public Library of the City of Boston, but you may prefer to make contact with our representative, Mr. Ernest F. Barry, Box G., Aster Station, Boston 25, who is deeply conversant with the whole problem and whom we are sure you would find very ready to give you any assistance or information which you require.

Yours faithfully,

(Signed) E.F.M. BUTLER
Secretary-General

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Abstract of Thesis

State Debt Repudiations in the United States

The subject of State Debt Repudiations in the United States has many aspects, namely, ethical, legal, economic, and social. The emphasis in this paper has been on the economic aspect, and, hence, Dr. Max Winkler's definition of repudiation has been taken as a guide:

"Governmental default, irrespective of classifications and erudite definitions, is briefly the repudiation by a government of a contractual debt owed by it either to domestics or foreigners, thereby rendering itself guilty of a breach of its obligations under domestic or international, and always moral, law."¹

The repudiations described herein were accomplished mainly by four methods: (1) "Scaling-Down" the debt. This was the most popular method and meant the replacement of an old debt by a new and smaller debt, rendered official by a legislative act whereby the State recognizes only the new debt. (2) Determination by a State Court that a particular bond issue was fraudulent and hence not binding on the State. (3) Declaration by the State Legislature that a specified bond issue was fraudulent and hence invalid. (4) Amendment to State Constitution pronouncing it illegal for the elected officers of the State to recognize specified debts.

¹ Winkler, M., Foreign Bonds (Philadelphia, 1933), p. 9.

Because the States must consent in order to be sued, attempts to collect through the Federal Courts have been unsuccessful.

The causes of State debt repudiations may be stated as follows:

1. Fraud and corruption were based on a disinterested majority of the electorate which tolerated continual mismanagement of State government.
2. Rapid internal development during the 1810-1840 period gave "talking points" to the legislators (who were also personally interested in banking and the construction of railroads and levees) and to the bond salesmen (whose commissions were high on State bond issues).
3. Because most of the investors placed their money in these bonds for the reasons that they sold under par and had higher interest rates than any others (two distinct signs of weakness), the investors were speculating and became parties to the mismanagement of the States.
4. There was unwillingness on the part of a successor administration of a State to recognize the contractual rights which had arisen between the State and bondholders during the course of previous administrations.

5. There seems to be a psychological belief that governments are good credit risks.
6. There was an inference that the United States government stood in back of the State bonds because (1) the relationship of sovereign State within sovereign nation was not understood in Europe, (2) the United States government invested in State bonds rather than investigating them, and (3) the United States government did not notify officially the governments whose nationals were investing in State bonds of the national government's inability to guarantee State bonds, based on an inability to interfere in the conduct of State finances.

Although several States have for shorter or longer periods been delinquent on bonds, principal or interest or both, the instances of State debt repudiation mentioned here concern particularly the eight States which are said by several experts to be the ones with bonds still outstanding.

In outline form, the major State debt repudiations are the following, which are listed in the order of their estimated totals in the year 1933.²

² See Winkler, M., op.cit., p.203. Also Howland, C.P., "Our Repudiated State Debts", Foreign Affairs, April, 1928.

<u>State</u>	<u>Purpose of Debt</u>	<u>Amount of Principal Outstanding*</u>	<u>Interest in Arrears *</u>	<u>Estimated Total in 1933*</u>
Louisiana	Railway & Settlement Loans	\$22,000	\$39,820	\$61,820
Georgia	Railway Loans	14,152	40,797	54,949
North Carolina	Railway & Tax Loans	13,886	40,429	54,315
Mississippi	Bank Loans	7,000	37,120	44,120
Florida	Bank and Railway Loans	7,900	28,380	36,280
South Carolina	Old State Debt & Railway Loans	7,500	25,005	32,505
Arkansas	Railway Loans	7,900	22,515	30,415
Alabama	Railway Loans	4,700	15,745	20,445
	TOTALS	\$85,038	\$249,810	\$334,849

* Stated in Thousands

Other States which were mentioned in the materials examined are the following: Illinois, Indiana, Maryland, Michigan, Minnesota, Pennsylvania, Tennessee, Virginia, and West Virginia. The first three found it necessary to suspend payment of accruing interest following the panic of 1837. Michigan paid the actual debt of the

State, but allowed State bonds to be bought on credit by unscrupulous bankers, who, after selling the bonds to foreigners, went bankrupt. A "Scale-Down" procedure was employed whereby only the money actually received by the State was paid back.

In 1880, Minnesota compromised at 50¢ on the dollar, and accrued interest, with the holders of an issue which possessed elements of financial irregularity.

Pennsylvania, from 1840-1845, suspended interest payments and, for a time, recognition of some debts, but later resumed payment.

Tennessee sought to justify a "Scale Down" settlement in a Funding Law of 1882 on the ground that illegal circumstances surrounded the issuance of the bonds.

In Virginia the Riddleberger Act of 1882 started the "readjustment" legislation which ended in 1892 with a so-called "final and satisfactory" settlement which incorporated some "Scaling Down" and some compromise with the bondholders. After much delay and litigation, West Virginia assumed a portion of the old Virginia debt, the portion being determined by the United States Supreme Court.

The effects of State debt repudiation may be described briefly as follows:

1. The credit of all the States and even the United States has been subjected to a cloud of suspicion, and, in many instances, actually lowered substantially.
2. The foreign bondholders became united in their efforts to collect on the repudiated bonds and these efforts still continue.
3. The debt repudiations still remain a topic of discussion in International Councils.
4. The subject remains a reason for intermittent international dispute.

Conclusions:

It seems clear that the Panic of 1837, the Civil War, and the Panic of 1873 are not the real reasons for the State debt repudiations. Rather, for every instance of repudiation there is a specific case of mismanagement. Investment firms, public officials, bank officers, and the executives of railroads and public works were so motivated by selfishness as to incur obvious irregularities in the handling of State bond issues.

The Federal Government aided the "wildcat" financing by remaining aloof at times (i.e., refraining from prosecutions) and by the appointment of incompetent officials during the "carpetbag" era.

Foreigners made investments mainly because of the high interest rates offered and could not have investigated all the facts of the bond issues, most of which had the earmarks of instability from the start.

Briefly, then, it can be said that all parties to these repudiations were either corrupt, on the one hand, or, on the other, quite reckless with their own funds or those of others.

The States can avoid a recurrence of repudiations only if they indulge in intelligent and comprehensive planning and honest administrations. To this end, Constitutional debt limitations are to be encouraged and the initiation of Special Funds, outside such Constitutional limitations, are to be specifically discouraged.

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